RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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**August 29, 1979** **LETTER 764**

Aug. 17, DJIA 883.36; PTI 1115; A-D Ratio –15.87
Aug. 23, DJIA 880.20; PTI 1123; A-D Ratio –15.96

**THE PICTURE:** (1) Since my last Letter, many concepts and ideas have dropped into place (in my mind), and the result is, to say the least, very exciting. Therefore, I believe that this could be my most important Letter since my "Special Report" written at the December, 1974 bottom.

(2) I have been writing for well over a year the importance (in the Fibonacci series) of not only the year 1979 but specifically of JULY, 1979. I noted (Letter 748) that no less than six time intervals in the Fibonacci series underscored July, 1979 as a key month in stock market history. I include an excerpt from that Letter below:

"Veteran readers know that the Fibonacci series is an integral part of the Elliott wave studies. The Fibonacci series is obtained by adding each two preceding numbers to obtain the next. For instance, 1 plus 1 equals 2; 2 plus 1 equals 3; 3 plus 2 equals 5; 5 plus 3 equals 8, and so forth to 13, 21, 34, 55, 89, etc. This series occurs so frequently in nature that it is utterly beyond coincidence. For instance, age of maturity is 21, 8 notes to the musical scale, 13 the beginning of the teen-age, 5 appendages to the body (head, two arms, two legs), five fingers to the hand, five toes, on and on.

"The following observations based on Fibonacci time sequences are listed. Those who wish to place them in the 'coincidental' category are free to do so.

"3 years from the 1976 top to the year 1979.
5 years from the 1974 bottom to 1979.
13 years from the 1966 top to 1979.
21 months from October, 1977 (where most secondary stocks hit bottom) to *July, 1979.*

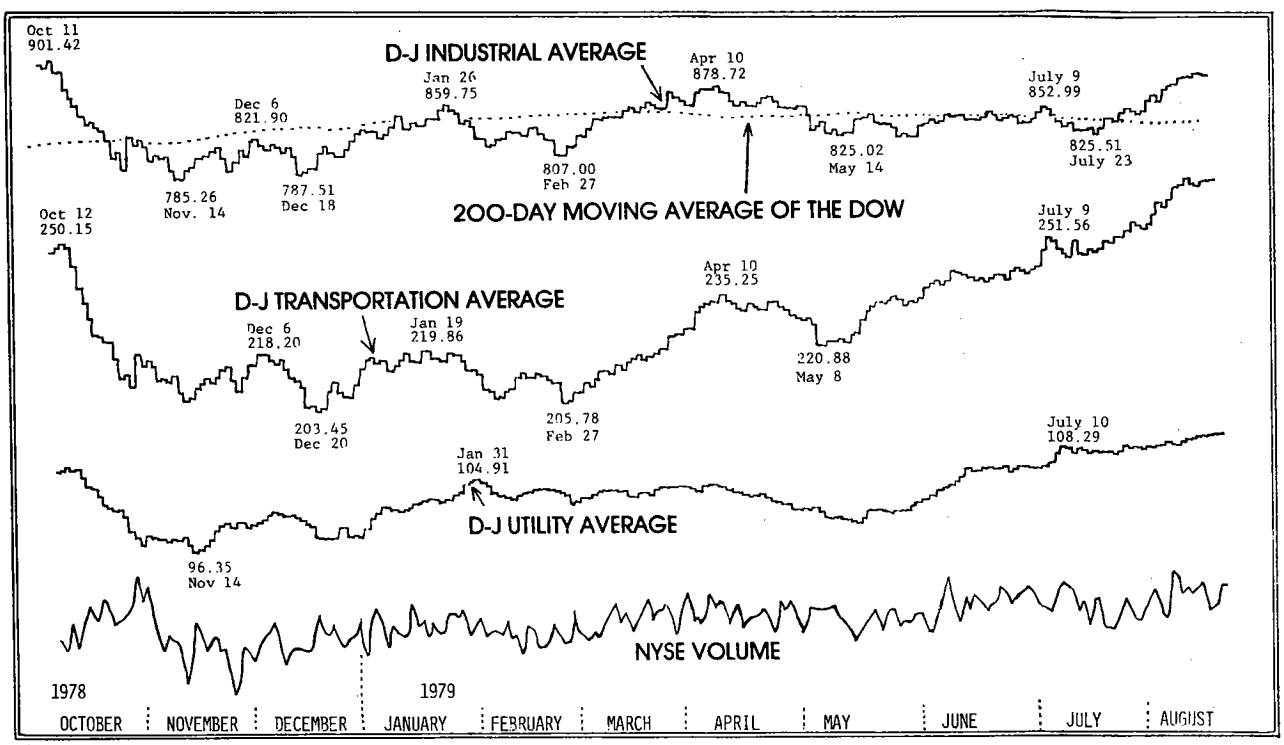
34 months from the September 21, 1976 Dow top to *July, 1979.*.
55 months from the December, 1974 Dow bottom to *July, 1979.*

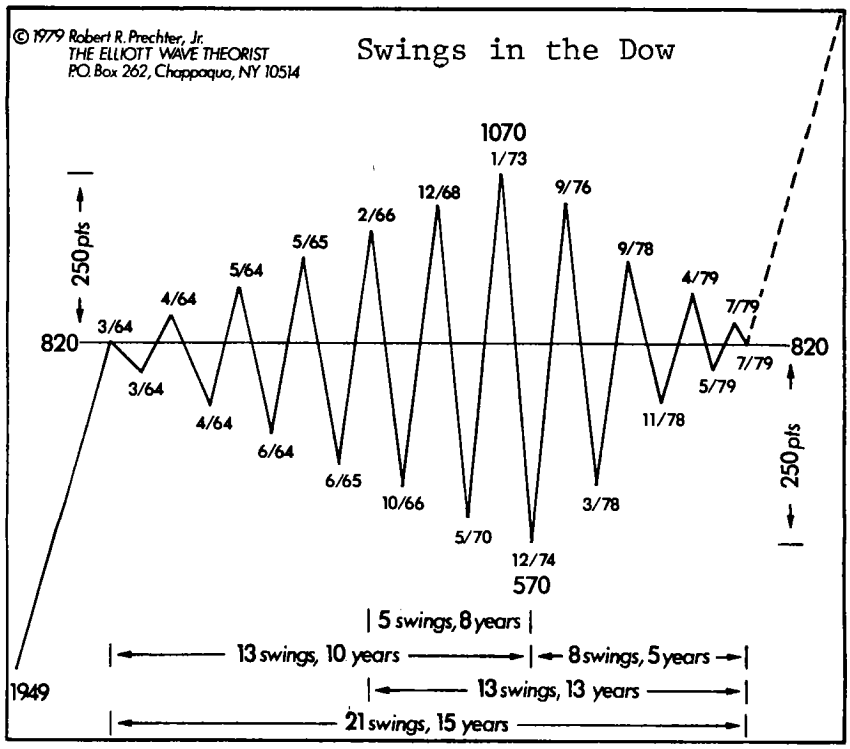
Thus, the six time sequences listed above point to the importance of the year 1979 and more specifically to JULY, 1979."

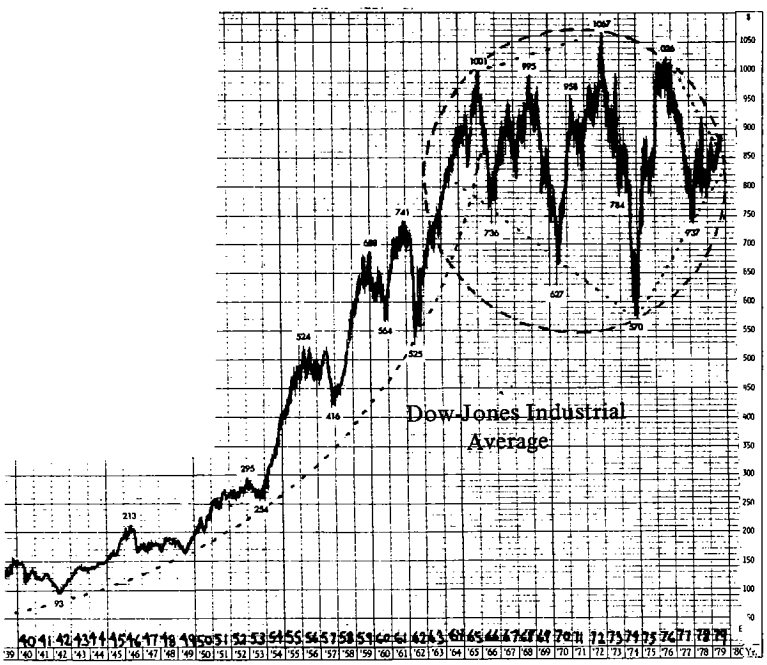
Yet, July, 1979 came and went, and I was unable to uncover the "secret" of what had happened.

(3) Now my brilliant friend, Bob Prechter (he publishes the "Elliott Wave Theorist") has come up with what I believe is the real meaning of the fateful month of July, 1979. With Bob's permission I reproduce (page 2) a dramatic chart from his latest report. Here we see 15 years of Dow action–1964 to 1979. Bob calls this whole formation a "sideways bull/bear market." During this time the Dow (using the 821 level as a fulcrum or pivot point) swung above and below the 821 level on 21 separate occasions. The Dow swung as high as 250 points above 821 (1973). And it swung as low as 250 points under 821 (1974). Note on the chart that from 1964 to 1973 the swings grew progressively wider. But from 1973 to 1979 the swings contracted steadily. This "spring-like" formation served as a correction for the entire 1964-79 era. On July 17, 1979, the 21st swing (this time a decline) brought the Dow to rest at 821. It was, Bob thinks, the LAST DOWN-SWING IN THE 15 YEAR PATTERN!

(4) Bob's analysis jibes with my own "great circle" concept of the Dow. I include again (page 2) my chart of the Dow and its great circle pattern. I have written repeatedly that I believe this






For the 5th wave of a bull market is the final, speculative wave, and the 5th wave of a giant bull market (such as the one pictured here) could be so powerful, so overwhelming, that it could wash away any counterforce in the same way that a tidal wave would sweep over a child's sand castle. And that may explain why so many time-honored market studies (many of them currently bearish) are not working at this time.

(6) On August 15 (page 1 chart) the Dow Industrials bettered their previous 1979 high (the previous high was 878.72 recorded on April 10). The Industrials thereby confirmed the bullish indications of the Transportation Average. From the standpoint of Dow Theory, a **bull market** was signaled as being in progress. Transports are now within less than 10 points from their all-time high of 279.88. Industrials should follow the Transport lead. IF Industrials can better the 1978 high of 907.74, they will (for the first time in 3 years) have bettered a preceding year's high. If Industrials can do that, they will have reversed their bearish series of successively lower tops since 1976.

I have also drawn attention to the huge triangle (page 3) that has formed in the Industrial Average since the 1976 high. This weekly chart (courtesy of Mansfield, 26 Journal Sq., Jersey City, NJ 07306) shows the triangle being broken to the upside two weeks ago. This is a bullish manifestation.

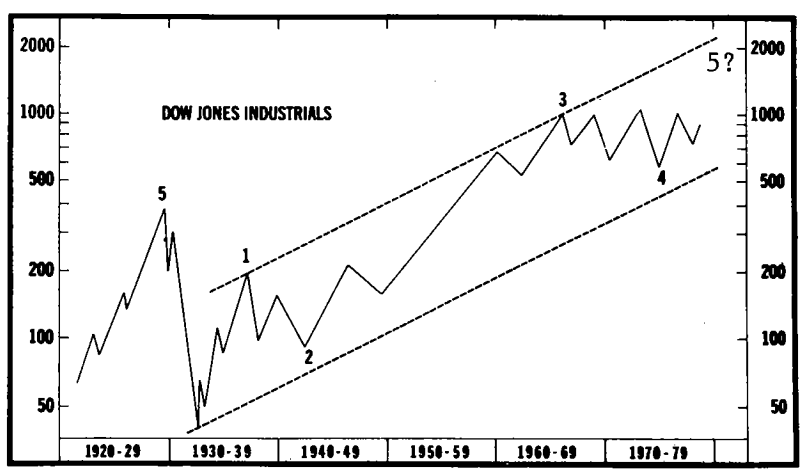
(7) I have recently noted that 4 time cycles *bottomed* during the final weeks of July, 1979. They were the 10-week, the 20-week, the 4.5 year and the 9 year cycle for the stock market.

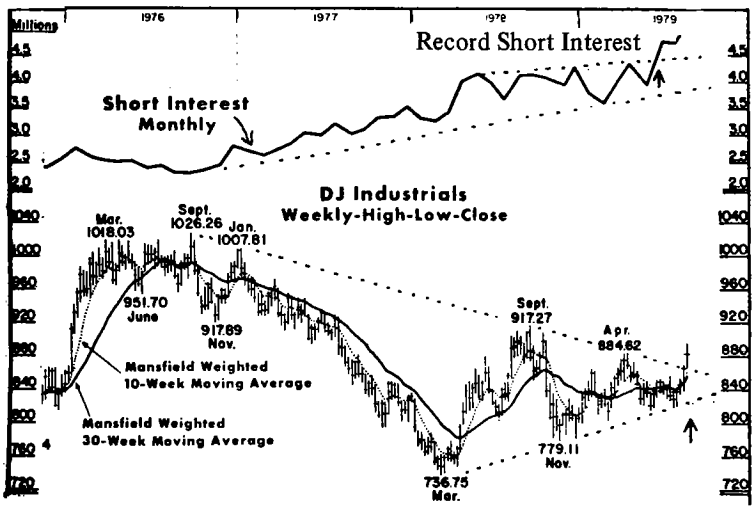
(8) The CHARACTER of the market has changed dramatically since mid-July. My Primary Trend Index is now moving up in a persistent, relentless manner. I don't think I have ever seen it act this powerfully. I cannot seem to get a single day's poor reading on the PTI. The action of the market since mid-July reminds me very much of the action of the market during the year 1958. That year saw the squeezing out and destruction of what was then a record short interest on the NYSE. This could happen again in the months ahead as the primary trend of the widely-watched DJIA asserts itself to the upside.

**Question**: Russell, what do you think is behind all the market phenomena that you describe above?

amazing circle contains the key to the next major move of the Dow. I have stated in recent Letters that the circle must break towards the end of 1979, and that the direction of the break (up or down) will point the next primary direction for the market. I am now of the opinion that the direction is up.

(5) In Letter 760 I published an Elliott chart showing the 4 super-cycle wave movements since 1932 (chart bottom right). These movements form the first 4 waves of what should be a great, 5-wave super-cycle bull market. The chart shows that we are now in the early stages of major wave 5. If so, if this is the *5th wave* of a giant bull market that began in 1932, then we are dealing with a phenomenon larger than any living person has had any experience with.

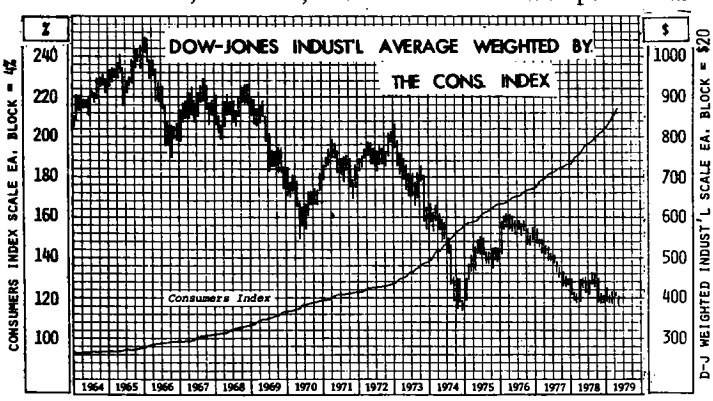





**Answer**: In a phrase, "too much pessimism–all in the face of a tide that is turning up." We read about investment seminars that are occurring across the nation (almost on a weekly basis). These seminars have been drawing huge crowds, from 1000 to 3000 people at a session. I have been a speaker at many of these seminars. The reigning emotion at these seminars is gloom. A great many Americans are very pessimistic, very discouraged at what they see now and what they think they see in the period ahead. In other words, gloom is what the American public now relates to, gloom is what it believes, and gloom is what it wants to hear. Gloom has become the mood and fashion of the day.

One by-product of this pessimism is that the public has been a heavy seller of stocks for years. Stocks have been sold through mutual funds, through odd-lot sales and through round-lot sales. Institutions and pension funds have cut way back on their equity holdings. Currently, the funds are historically high in cash. A record short-position of 50 million shares has built up on the NYSE.

In the face of this, I believe that **July, 1979** represented the watershed month, the turn, the bottom month for pessimism.


DOW-JONES INDUST'L AVERAGE WEIGHTED BY THE CONS. INDEX
Consumers Index
CONSUMERS INDEX SCALE EA. BLOCK = 4%
D-J WEIGHTED INDUST'L SCALE EA. BLOCK = $20

I include a chart (courtesy of Horsey, Salisbury, MD 21801) which shows price/earnings ratios for the Dow going back to 1942. Note that from 1942 (a year of great pessimism) to 1961 (great optimism) the P/E's rose from 7 to 24. Then from the 1961 peak of 24 the cycle turned down, and the P/E's dropped to the 1974 low of 6. In 1974 they were giving away the Dow at only 6 times earnings, at below book value, at yields of over 6%. By early 1976 P/E's rose to 13, but they then dropped back to July, 1979's low of 6.7 again. This double bottom in the 6-7 P/E area, I believe, will stand as the turning-point low in pessimism. Right now the P/E's are still in the low 7 area.

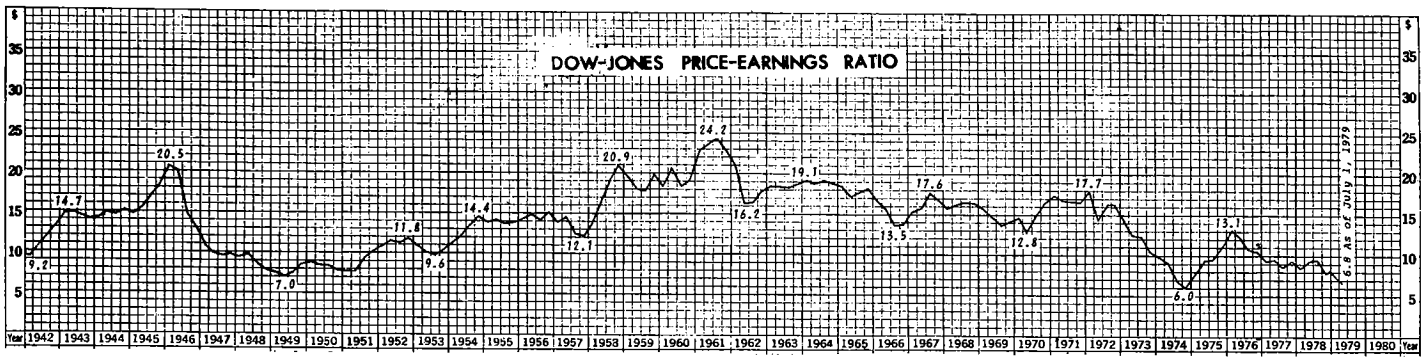
As the 5th Elliott wave unfolds, I would guess that we will see the greatest single force in the market start operating again. It will be operating for the bulls. What is that force? It is a rise in optimism as expressed through a rise in P/E ratios. Before the 5th wave is over, we could see P/E ratios for the Dow double or even triple.

**Question**: Why haven't the rising AMEX and O-T-C markets turned the public bullish?

**Answer**: The public doesn't follow the AMEX or the O-T-C markets. They don't follow the bank stocks or the insurance stocks. They FOLLOW THE DOW. When the Dow moves up, the world knows that the market is turning bullish. When the Dow moves up **persistently**, the public (in time) will turn bullish. That's what I believe lies ahead. Bob Prechter believes we have now (since July) changed from a 15-year "buy 'em and sell 'em" trading market to a new "buy and hold" investment market. I agree. The big money will be made during the 5th wave by buying and holding stocks. Few brokers working today have ever seen this kind of market.

**Question**: How will all this affect the price of gold, houses, things?

**Answer**: If I had to guess I would say that gold and tangible items will continue to rise but only in line with inflation–not beyond the inflation rate. One of the indices I will be watching with great interest is my gold/stock ratio (seen in the last Letter). I would guess that the 3.5 year rise in this ratio will be reversed somewhere ahead. If it does reverse, this will be my signal. It will be a signal which says that the market is beginning to recognize that stocks are the "cheapest thing around," that stocks are the only items you can still buy at 1960's prices. In proof of that statement, I include this chart showing the Dow adjusted for inflation (chart courtesy of Horsey). In terms of the 1976 dollar, this chart shows that the Dow hit 400 in 1974, rallied, and is now back at 400 again. In other words, the Dow is now back at the 1974 crash lows in terms of 1967 dollars. How would you like to buy a house at 1967 prices?!



**Question**: Russell, I still don't get it.These same facts have been true for many many months. Why are you so excited about it now?

**Answer**: In a word, TIMING. You can sit forever with a bargain. You can go broke holding bargains. What I'm saying in this Letter is that the low for pessimism has passed, July was it. If I am correct, today's gloom should give way to 1980 and 1981 optimism. The 15-year sideways movement of the Dow should have ENDED. If pessimism has hit bottom, then the P/E ratios have nowhere to go but up. When that happens, the big stocks and everything else will move higher. And I don't care if earnings stand still or move down somewhat. The big swing factor in the market is not earnings, it's **what people will pay for earnings!**

**Question**: Russell, this is all very fascinating, but let's get down to the real world and the current situation. Your PTI has been telling some kind of a bullish story. What do you make of it?

**Answer**: The PTI has been rising in a persistent, relentless manner. It has been plowing upward while the Dow and many leading stocks have been refusing to rise. But the PTI has been telling us that the technical climate, the technical under-pinnings of this market have been ripe for an upward sweep. The PTI is now at its highest level since I began computing it in mid-1971. I don't know exactly what that means, but I believe it means that in time the Dow will follow. And again I'll say that in my opinion July, 1979 marked the pivot month, the month in which the Dow should start joining the PTI.

**Question**: What about a market correction here?

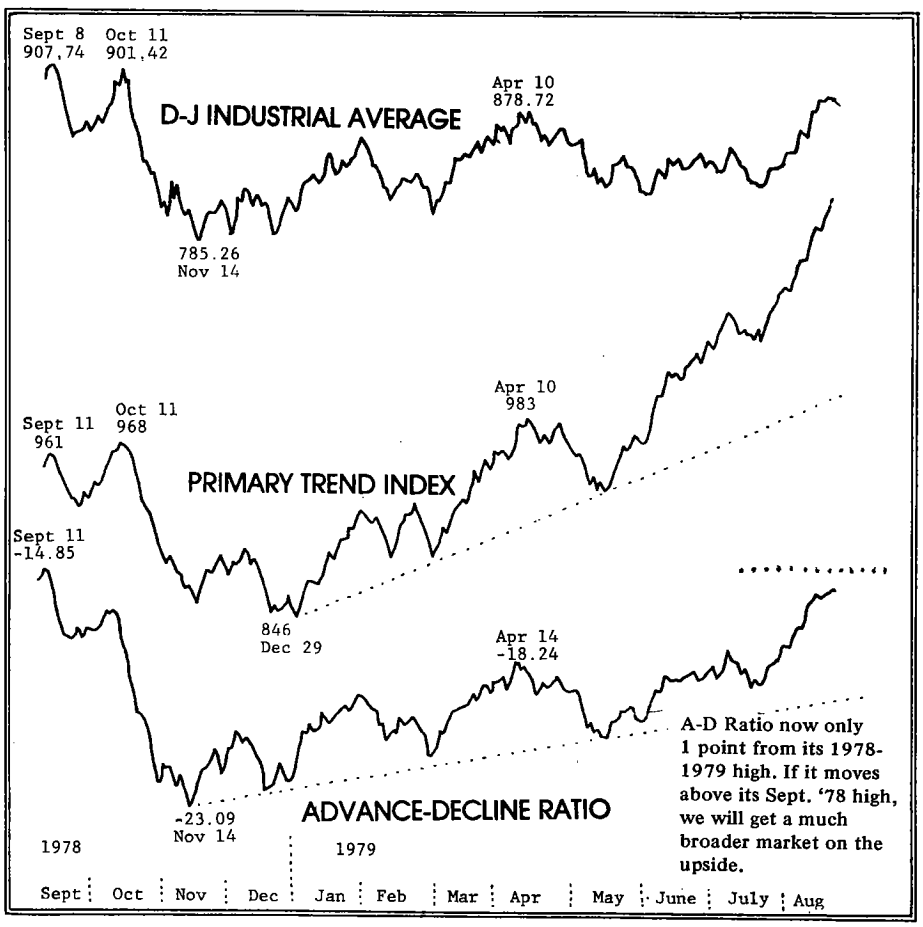
**Answer**: It could easily happen. September and October (on an historical seasonal comparison) are the two likeliest months of any year for a correction. Ordinarily I would expect an August or early-September top and then a good correction into October-November. But I'm not at all sure we're going to get that drastic corrective action. What I am watching for is the KIND of action we get during the September-October period. If the market simply becomes irregular, if the Averages form a "line," if we have a mild correction, then I would consider that very strong action.

In other words, the market is over-bought now, but in strong markets, Wall Street can work off an over-bought situation through time rather than through a serious decline. That's why I think the September-October action will be the tip-off as to what we can expect through the rest of 1979 and into 1980. So far, the PTI has been backing off with great reluctance, and as I have said before, you can't have a strong PTI and a collapsing market (see chart).

As a further point of interest, Lowry's service tracks longer term buying power and selling pressure on the NYSE. Last week buying power rose to its highest level in 2½ years while selling pressure sank to a 9 month low. Thus, buying from "somewhere" is entering this market in an impressive way, but the reason it is not more apparent is that the buying has had such a mass of supply to chew through. Thus, we get the appearance of churning day after day. With selling pressure declining, however, I do not see the action as churning but as a steady, grinding move through the overhead supply.

**Question**: In Letter 761 (July 18) you started recommending equities again. What prompted that change?

**Answer**: In all honesty, a gut feeling plus a study of my PTI. I also bought a new home that month. Something "changed" in me and my unconscious .




But in my opinion this is the time when subscribers should be taking positions in equities (I think the closed-end funds or the open-end funds are good places to start). Madison Fund and US & Foreign Securities (both closed-end and listed on the NYSE) have moved up smartly since I recommended them. But they still sell at substantial discounts from net assets, and still provide a good total return. Frankly, I'm not interested in my subscribers' beating the market with this or that stock now. I'm interested in my subscribers' getting a basic position, a broad participating position in stocks now, and then sitting with that position. Thus, they will be "getting their feet wet." As and if this market proves itself on the upside, other positions can be instated. But it is important to get in early. If the Dow goes over 1000 it will be harder to buy ("I should have bought earlier, it's too late now"). So, this is the time to move. I can't move you. I can only advise you. You have to move yourself!

**Question**: You've listed Madison Fund and US & Foreign Securities (both NYSE) as closed-end funds that you like. Russell, what mutual (open-end) funds do you like?

**Answer**: I like Fidelity Equity-Income Fund, 82 Devonshire St., Boston, Mass 02109 (800-

525-6190). I like Energy Fund, 522 Fifth Ave., NYC 10026 (212-790-9800), I like Mutual Shares Corp., 170 Broadway, NYC 10038 (212-267-4200), I like T. Rowe Price's New Era Fund, 100 E. Pratt St., Baltimore, MD 21202 (800-638-1527), and I like American Investors Fund, P.O. Box 2500, Greenwich, CT 06830 (203-622-1600).

Since July 17 the Dow (on the basis of a 13-week rate of growth) has outperformed the broad NYSE Index. If the Dow is going to continue this kind of action, then it follows that there have to be some Dow "movers" in the period ahead. Sheldon Dike (1420 Carlisle Blvd. NE, Albuquerque, NM) keeps track of growth rates on all Dow stocks on both an intermediate term (13-week) and long-term (65-week) rate of growth basis.

Over the intermediate-term the top five Dow stocks are Westinghouse, Allied Chem, General Food, Union Carbide, American Brands. On a long-term basis the top growth rates are now being exhibited by Woolworth, Int. Nickel, Alcoa, American Brands, Standard of California. Note that Amer. Brands is on both lists. Note that there are two metals (Alcoa and Nickel) on the long-term growth list. A package of any of the above-listed stocks should make a good investment package.

**Question:** What percentage of assets would you have in common stocks now?

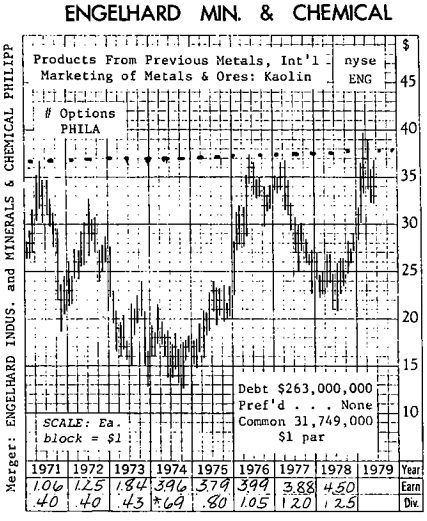
**Answer:** I'd be in common stocks up to 25 to 33% of assets at this time. I'd have another 10% to 15% in gold and the rest in T-bills or equivalent with perhaps 15% in bond funds. As far as the common stock portion of the portfolio, I believe in increasing one's position as the market confirms our judgment. The next upside confirmation would be (1) the Dow breaking into the 908 area, and (2) the A-D ratio pushing above its September, 1978 high.

**Question:** Russell, what about the rising debt structure in this nation, an ominous structure that you've written about repeatedly.

**Answer:** Again, I will state that everything is timing. The market is telling me that the "timing for trouble" is being placed further out, perhaps during 1981 to even 1983. But the picture I want to act on now is the one described in this report.

I spent about three hours going through the monthly charts (Horsey charts) of hundreds of stocks. I picked out 6 companies with huge bases, bases that would seem to imply massive accumulation. These stocks are **FMC Corp., Pennzoil, Englehard, SCM, Rockwell and Xerox.** I include three of these monthly charts so that you can see what I am talking about. I do not profess to know what's behind these huge base formations. But these bases do allow for MUCH higher prices.

ENGELHARD MIN. & CHEMICAL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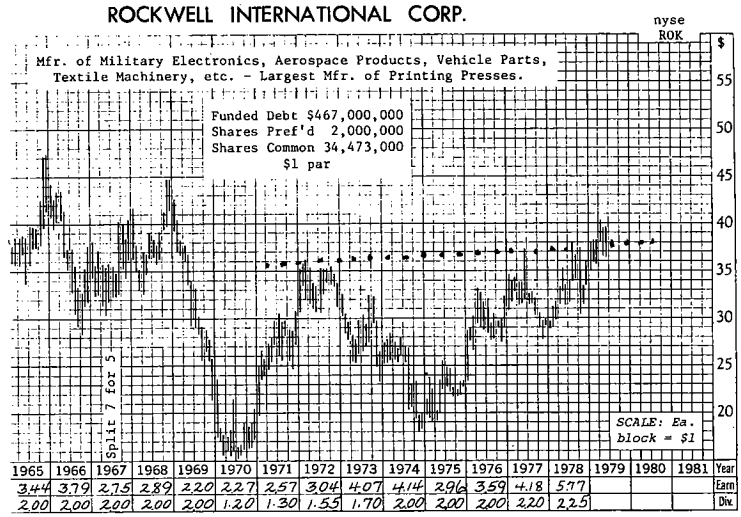
ROCKWELL INTERNATIONAL CORP.

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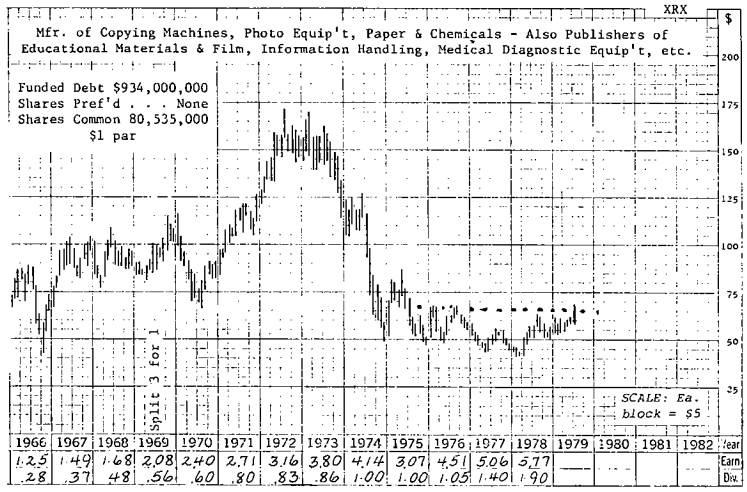
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Mfr. of Copying Machines, Photo Equip't, Paper & Chemicals - Also Publishers of Educational Materials & Film, Information Handling, Medical Diagnostic Equip't, etc.
Funded Debt $934,000,000
Shares Pref'd . . . None
Shares Common 80,535,000
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Split 3 for 1
SCALE: Ea. block = $5
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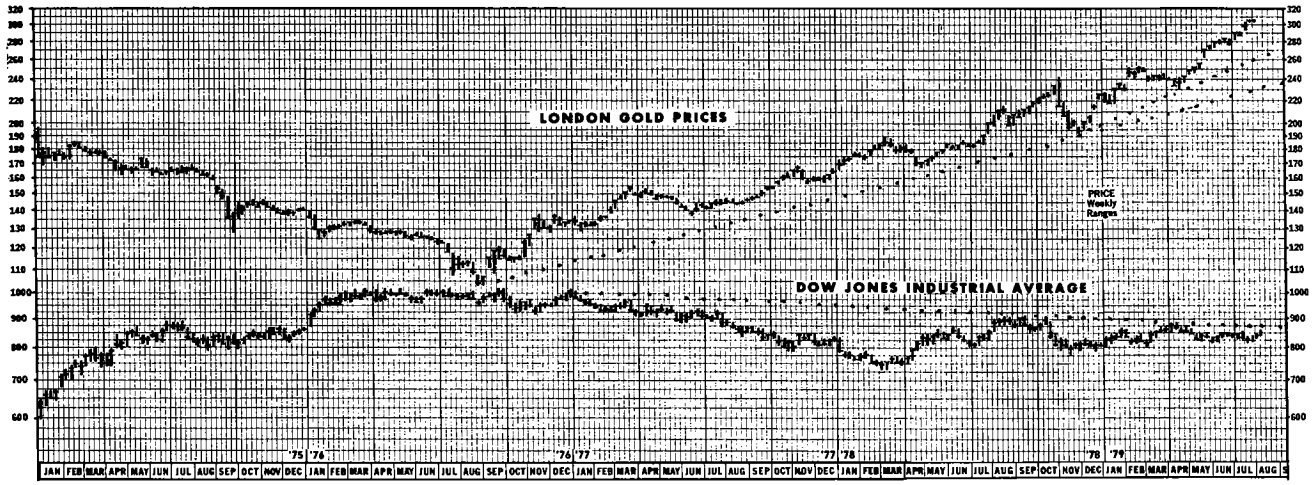
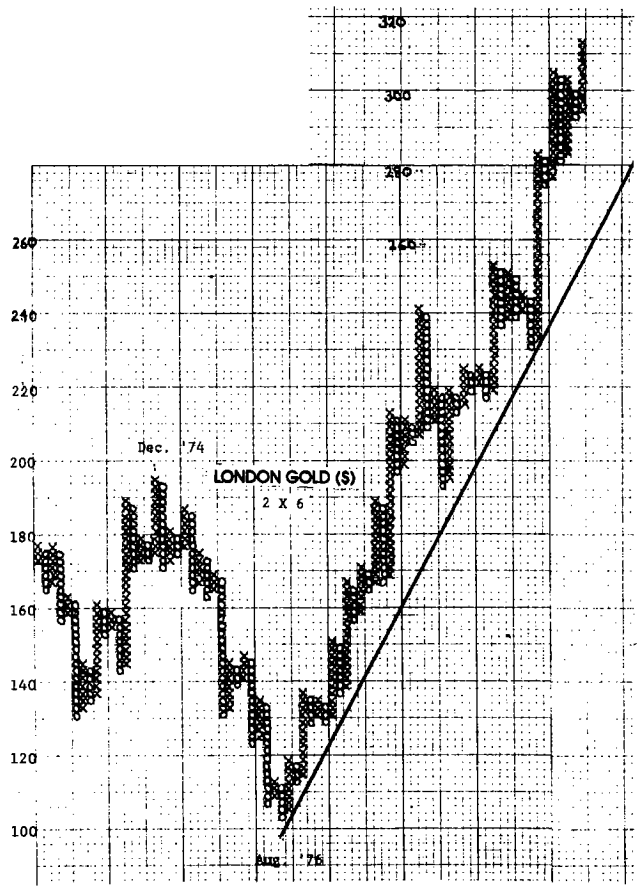
**GOLD:** On the top of page 6 I have included a chart showing the weekly range of both gold and the D-J Industrial Average. Quite a fascinating chart, I thought. The chart shows a move towards "togetherness" all during 1975 and most of 1976. But from August, 1976, gold and the Dow part company. The trendlines I have drawn in tell the story. It's a story of "higher and higher for gold," "lower and lower for the Dow."

If the Dow can move over 900 the story will change, and then it will be a higher Dow and maybe still higher gold. We'll wait to see. However, I do want to stress that both of these trends are growing very old, and that's why the picture is so interesting. But as every technician knows, a trend is taken to REMAIN IN FORCE until proved otherwise. The "otherwise" is a rupturing of either of these two trendlines. (Chart courtesy of Securities Research, 208 Newbury St., Boston, Mass 02116).

My 2x6 point & figure chart may turn out to be the most famous "one liner" on Wall Street. The one line is the trendline that I show on the chart. If gold were to collapse tomorrow, it would hit the rising trendline at around 260. Until then, despite




gold's long ascent, despite the guesses and curses of its detractors, the trend is up for the King's metal.

My third chart is a semi-log chart of gold, and I must say that this is an extraordinary chart. When you draw a rising trendline on any semi-log paper, the inference is that as long as the item holds above that trendline a steady rate of growth is being maintained. But what I did here was fit a Phillip's Curve (an engineering instrument) to the path of gold. And it's clear that gold is doing a lot better than holding above its trendline. It's holding to a rising Phillip's Curve, and this can only mean a move towards an exponential rate of ascent (literally straight up) or a breaking of the curve.

In any case, the acceleration is clear for all to see, and how long gold can hold to its current accelerating growth rate is anyone's guess. I said in the last Letter that gold is no longer a trading vehicle. You hold it and wait, or you sell it and perhaps repent.

I've been studying my chart of spot gold and its moving averages. At present spot gold is about 26 points above its 13-week moving average (MA). The 13-week MA for gold is now 288. There were only 4 other occasions in the last few years in which spot gold was 26 points or more above the 13-week MA. In each of those instances, irregularity or a correction followed.

Thus, with gold well above the 13-week MA we could see a short-term period of straining, irregularity or correction. But as far as the trend is concerned, I don't see anything so far to suggest that gold's trend is anything but bullish.

Many older gold holders are nervous about gold at "over 300." Where a bull trend is concerned, it's best to lay aside preconceived notions about "what has to stop where." But one procedure you might follow is to set a *fixed percentage* (10%,15%,etc.) of your assets that you want to keep in gold. Then if gold rises, and that rise results in your gold percentage of assets increasing, sell off just enough gold to bring you down to your fixed percentage of assets again. This way, you will automatically take profits but always have a certain fixed percentage of assets in gold (you can buy back your gold if the price goes down and your fixed percentage declines).

**NEXT MAILING: September 12th**